Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

WEST 14TH STREET COMMERCIAL CORP.,
WEST 14TH STREET GARAGE CORP., AND
WEST 14TH STREET LAUNDRY CORP.,

Petitioners,

v.

5 WEST 14TH OWNERS CORP.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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65 pgs

QUESTIONS PRESENTED

1. In a case of first impression arising under the Condominium and Cooperative Abuse Relief Act of 1980, which potentially affects thousands of residential properties nationwide, did the United States Court of Appeals for the Second Circuit misinterpret 15 U.S.C. § 3607, thereby permitting the shareholders of a housing cooperative to terminate valuable agreed to and bargained for leasehold interests of others simply by a vote of the shareholders, free of judicial review, where Congress has provided for termination of leasehold interests in 15 U.S.C. § 3608 only upon a showing before a court that the leasehold interest contained unconscionable terms?

2. Did the Second Circuit elevate form over substance and err in finding that the provisions of 15 U.S.C. § 3607(a)(3) for termination of a contract are satisfied regardless of the fact that state law precluded the developer from unilaterally dictating contract terms and thereby gaining the "special developer control" required by the statute?

LIST OF PARTIES AND RULE 28.1 LIST

The parties to the proceedings below were petitioners West 14th Street Commercial Corp. ("Commercial Corp."), West 14th Street Garage Corp. ("Garage Corp."), West 14th Street Laundry Corp. ("Laundry Corp.") and respondent 5 West 14th Owners Corp. (the "cooperative" or "Owners Corp.").

Each petitioner is an affiliate of the other petitioners; petitioners have no parent companies, subsidiaries or other affiliates to list pursuant to Rule 28.1.

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Petitioners,

v.

5 WEST 14TH OWNERS CORP.,

Respondent.

Petitioners Commercial Corp., Garage Corp. and Laundry Corp. respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit, entered in the within proceeding on March 18, 1987.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit is reported at 815 F.2d 188 (App. A, *infra,* 1a-25a). The decision of the United States District Court for the Southern District of New York (Knapp, D.J.) is reported at 625 F. Supp. 934 (App. B, *infra,* 26a-42a).

JURISDICTION

Invoking federal jurisdiction under 15 U.S.C. § 3612 and 28 U.S.C. § 1331, petitioners brought suit in the United States District Court for the Southern District of New York for declaratory and injunctive relief. On January 13, 1986, that court granted petitioners' motion for summary judgment on their first claim for relief.

On respondent's appeal, the Second Circuit entered a judgment and opinion affirming the District Court's judgment in part, reversing it in part and remanding the case solely for the purpose of entry of judgment. No petition for rehearing was sought. The jurisdiction of this Court to review the judgment is invoked under 28 U.S.C. § 1254(1). On the issue of the finality of the Second Circuit's judgment, petitioners rely upon *Chicago v. Atcheson Topeka and Santa Fe Railroad Co.*, 357 U.S. 77 (1958).

STATUTE INVOLVED

The statute involved is 15 U.S.C. § 3607, which is part of the Condominium and Cooperative Abuse Relief Act of 1980 (the "Abuse Relief Act") (15 U.S.C. §§ 3601-16):

§ 3607. Termination of self-dealing contracts

Operation, maintenance, and management contracts; penalty

(a) Any contract or portion thereof which is entered into after October 8, 1980, and which —

(1) provides for operation, maintenance, or management of a condominium or cooperative association in a conversion project, or of property serving the condominium or cooperative unit owners in such project;

(2) is between such unit owners or such association and the developer or an affiliate of the developer;

(3) was entered into while such association was controlled by the developer through special developer control or because the developer held a majority of the votes in such association; and

(4) is for a period of more than three years, including any automatic renewal provisions which are exercisable at the sole option of the developer or an affiliate of the developer,

may be terminated without penalty by such unit owners or such association.

Time of Termination

(b) Any termination under this section may occur only during the two-year period beginning on the date on which —

(1) special developer control over the association is terminated; or

(2) the developer owns 25 per centum or less of the units in the conversion project, whichever occurs first.

Vote of owners of units

(c) A termination under this section shall be by a vote of owners of not less than two-thirds of the units other than the units owned by the developer or an affiliate of the developer.

Effective date of termination

(d) Following the unit owners' vote, the termination shall be effective ninety days after hand delivering notice or mailing notice by prepaid United States mail to the parties to the contract.

STATEMENT OF THE CASE

This case presents several important issues of first impression under the Abuse Relief Act, a statute passed in 1980 as Congress' first, and as of yet, only regulatory effort in the field of cooperative and condominium conversions. For four years the statute was not applied. In the last two years, however, a tidal wave of litigation involving this statute has descended upon the district and state courts, with at least twelve cases pending before the New York state and federal courts alone. *See* App. C,

infra, 43a. Many of these cases have been in some form of suspense status pending the outcome of this case.

The parties before this Court address issues that are potentially present in thousands of existing and future cooperative and condominium projects throughout the country. The United States Census Bureau reports that from 1973-1981, approximately 1,136,000 owner-occupied cooperative and condominium units were created. In the first quarter of 1984, 8 percent of the families purchasing housing bought a condominium or cooperative. *See* Wald, *Co-ops and Condominiums: The American Dream Is Changing*, N.Y. Times, Oct. 28, 1984, § 12, p. 1, col. 1.

Although the building at issue here is a large mixed-use 429 unit apartment house, with four commercial stores, a 150 car garage, and separate laundry facilities (JA 12-14),[1] the matters at issue necessarily apply to any rental housing complex, large or small, which has been or will be converted to cooperative or condominium ownership. Such projects exist throughout the country and in just about any place where multifamily rental housing can be built.

After many years as a rental facility, the building here was converted to cooperative form in 1984. Typically, in such a conversion, the sponsor sells the building to his tenants through the form of a cooperative corporation which issues shares of its stock and proprietary leases entitling the tenant to occupy his apartment.

The sponsor, Parman Co., sold the building to Owners Corp., but retained an interest in the four commercial stores, the garage and the laundry facilities in the form of two leases, one each for the garage and commercial facilities, and a concession agreement for the laundry room. (JA 23-81).[2] This transaction

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[1] References abbreviated "(JA_____)" are to pages of the Joint Appendix prepared by the parties for respondent's appeal to the United States Court of Appeals for the Second Circuit.

[2] Specifically, Commercial Corp. is the lessee of the commercial space; Garage Corp. is the lessee of the garage; and Laundry Corp. is the concessionaire of the laundry facilities. All three corporations are affiliates of the sponsor, Parman Co. Owners Corp. is the landlord under the two leases and grantor of the laundry concession.

was one of several ways in which the sponsor could have realized an economic interest in the property which it developed and owned. The sponsor could have sold or leased these interests to a third party before the conversion, or as in a condominium-type conversion, retained a fee interest in the properties. The sponsor could have transferred the garage and commercial space to the cooperative and charged a higher price for the apartments. However, after two years of strenuous negotiations with the tenants in occupancy, the sponsor here retained the leasehold interests in exchange for substantial discounts in purchase price and other economic benefits to those tenants who purchased their apartment units.

The building was at all relevant times subject to New York State and City's rent stabilization laws and the provisions of New York State's Martin Act, New York General Business Law §§ 352-eeee *et seq.* (McKinney 1984). The Second Circuit's opinion accurately describes the effect of these laws and the inability of the sponsor to convert the building under terms the sponsor alone determined:

> After Parker — the owner of the subject high-rise multiple residence building at Fifth Avenue and 14th Street in Union Square — decided to convert the building to a cooperative, it filed an Offering Plan in 1982 that included the three contracts in question. In response the tenants organized the P.G. Tenant's Unity Group (Unity Group) and collected no-buy pledges from over 65% of the tenants. These actions deprived the developer of the number of inside buyers it needed to evict non-buying tenants under New York's Martin Act, N.Y. Gen.Bus.Law § 352-eeee (McKinney 1984), amended by 1982 N.Y. Laws c. 555 § 2. Parker then proposed a non-eviction plan which, to become effective under the Martin Act, required that 15% of the insiders purchase their apartments. *Id.* Obtaining subscriptions from only 4% of the tenants, the developer was forced into negotiations with Unity Group.

815 F.2d at 190 (App. A, *infra*, 4a). Thus, by using the bargaining power granted to them by state law, the tenants prevented the sponsor from converting the building under its own

terms. As the Second Circuit observed, the sponsor was "forced into negotiations." *Id.*

As a result of these negotiations, the tenants used their bargaining leverage to obtain better terms for the conversion than the sponsor had unilaterally proposed in its original offering plan, including a 40 percent reduction in the price of apartments (JA 20), and substantial increases in the rentals the sponsor's affiliates would pay to the cooperative under the two leases. (JA 19-20). After the parties' counsel agreed on the essential terms of the transaction, the majority of tenants accepted the plan, and the parties closed on September 6, 1984. (JA 371, 455-56). Counsel for the tenants attended this closing and examined all the relevant documents, including the leases. (JA 455-56). Only after the tenants' counsel had approved these documents did title to the building pass, allowing the individual tenants to close on their apartments. (JA 456-57).

Ten months later, on June 12, 1985, the cooperative's shareholders voted to terminate the two leases and the concession agreement under the Abuse Relief Act. Petitioners immediately brought suit in the Southern District of New York for a declaration that the statute did not permit the cooperative to terminate these agreements, and for a declaration that the statute violated the due process clause if it permitted such a termination. After both sides made motions for summary judgment, the District Court held that the cooperative could not terminate any of these agreements because of the extensive negotiations which preceded their execution. 625 F. Supp. at 941-43 (App. B, *infra*, 38a-42a).

The cooperative appealed, and raised for the first time on appeal an objection to the District Court's subject matter jurisdiction. The Second Circuit found that the District Court had subject matter jurisdiction (815 F.2d at 191-96, App. A., *infra*, 6a-15a), but arrived at a completely different interpretation of the Abuse Relief Act than that of the District Court, holding that the cooperative could terminate both the garage lease and the laundry concession. The court held that the commercial lease could not be terminated, because it was not a contract for the management of property "serving" the unit owners within the

meaning of § 3607(a)(1) of the Abuse Relief Act. 815 F.2d at 199 (App. A., *infra*, 20a-21a).

REASONS FOR GRANTING THE WRIT

I. Section 3607 of the Abuse Relief Act Does Not Apply to Leases in Which the Developer Retains a Leasehold Interest in Cooperative or Condominium Property.

In ruling that § 3607 applied to leases, the Second Circuit failed to give full effect to the Congressional compromise over the scope of another provision of the Abuse Relief Act, § 3608, and failed to observe elementary rules of statutory construction. After this decision, as a practical matter, the statute now applies only to cooperatives, and the title Condominium and Cooperative Abuse Relief Act is now a misnomer.

The circuit court rendered an extremely tortured interpretation of § 3607 which was warranted neither by the language of the statute nor by its legislative history. Indeed, the court's construction of the statute leads to absurd results: a reservation by the developer of a leasehold estate for more than three years is subject to termination, but the reservation of a fee interest forever is not. The decision, if not reversed, will permanently alter the way that condominiums and cooperatives are converted throughout the country and will result in windfalls for shareholders at the expense of unsuspecting sponsors. The result will not be a careful balancing of the interests of tenants and developers, as the Second Circuit envisioned, but rather the exaltation of form over substance, to the detriment of all parties involved in the conversion process.

The Abuse Relief Act contains two operative sections: § 3607, which provides for non-judicial termination of contracts for the operation, maintenance or management of a cooperative or condominium association, or of property "serving" the owners, and § 3608, which provides for judicial termination or reformation of certain unconscionable leases. Section 3608 is narrowly drawn, and applies only to leases of property *from* the developer *to* the cooperative or condominium association entered into before June 21, 1975. 15 U.S.C. § 3608(a). It requires the cooperative

to prove in court that the lease is in fact unconscionable, and sets forth standards to guide the court in making its determination.

The legislative history of the Abuse Relief Act makes clear that § 3608 was intended to address a specific abuse in condominium and cooperative leasing in Florida. There, developers leased recreational facilities *to* the owners' association, requiring the members to pay escalating rental charges. Florida had passed legislation to ban these practices prospectively, but Congress believed that Florida was constitutionally unable to invalidate these leases retroactively. Thus, Congress made the statute applicable only to leases entered into before June 4, 1975, the effective date of the Florida legislation. *See* 126 Cong. Rec. 28,179 (1980); 126 Cong. Rec. 28,444 (1980).

The proponents of the Abuse Relief Act wanted § 3608 to provide for prospective, as well as retroactive, relief. The original Senate bill so provided, but the House refused, and the conference report provided for only retroactive relief. *Id.*; S. Rep. No. 736, 96th Cong., 2d Sess. 172, *reprinted in* 1980 U.S. Code Cong. & Ad. News 3506, 3717. Indeed, this compromise drew criticism from Senator Harrison Williams, one of the bill's principal proponents, who wanted the statute to accomplish more. *See* 126 Cong. Rec. 28,179 (1980).

The Second Circuit could not and did not rule that § 3607 applied to *all* leases. Such a ruling would have allowed a cooperative or condominium burdened with a lease of property to avoid the hearing required by § 3608 simply by terminating the lease under § 3607. Not even the Senate proponents of an expanded § 3608 were willing to do that. Instead, the Second Circuit simply rewrote § 3607, and made it applicable only to leases from the cooperative or condominium as landlord to the developer affiliate as tenant: "[h]ence, the limitations of § 3608 are not undercut if § 3607 is construed to apply to leases where the cooperative association is the lessor." 815 F.2d at 197 (App. A., *infra*, 18a). If § 3607 is so limited, the Second Circuit reasoned, the intent of the Congressional compromise over § 3608 could be preserved.

However, the Second Circuit cited no language in § 3607 to support a distinction between a lease to the cooperative and a

lease from the cooperative, because there is none. The statute simply refers to "contracts." The floor debates provide no support for this distinction at all. Indeed, to the extent that the debates touched upon § 3607 at all, they are particularly unenlightening.[3] Congress was concerned with escalating leases for recreational space in Florida, where the cooperative association is a tenant.[4] There is no evidence that Congress ever considered abusive leasing practices where the cooperative is landlord. Thus, the Second Circuit's opinion has the ironic effect of making § 3607 completely inapplicable to the leasing practices that Congress investigated and was concerned about, and applicable to leases that Congress never even considered.

The Second Circuit failed to draw the logical conclusion from the conflict between the provisions of § 3608 and § 3607: namely, that § 3607 should not be interpreted to apply to leases at all. An analysis of the Florida legislation, which Congress copied — with one notable exception — supports this conclu-

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[3] At one point in the Congressional debates, Senator Williams made a passing remark, quoted in the Second Circuit's opinion (815 F.2d at 198, App. A, *infra*, 18a), that § 3607 was a method to avoid a long term "leasing arrangement." 126 Cong. Rec. 28,178 (1980). Shortly thereafter, Senator Garn complained about "inserted statements in this floor debate regarding many provisions in the conference report. Neither I nor others in this body have seen these statements and so they cannot be said to represent the intentions of the conferees." 126 Cong. Rec. 28,180 (1980). Furthermore, the Second Circuit's reliance on the Senate Report (815 F.2d at 198, App. A., *infra*, 18a) was equally mistaken. The comments cited by the court relating to "lease provisions" (*Id.*) were comments to the earlier Senate draft of § 3608, which provided for a ban on self-escalating rents in recreational leases — and not to § 3607. *See* 1980 U.S. Code Cong. & Ad. News 3559, 3584-85, 3600-01.

[4] *See* 126 Cong. Rec. 15,963 (1980); 126 Cong. Rec. 16,081 (1980); 126 Cong. Rec. 28,174 (September 30, 1980); S. Rep. No. 736, 96th Cong., 2d Sess. 95-96, *reprinted in* 1980 U.S. Code Cong. & Ad. News 3506, 3600-01.

sion. The relevant provisions of the Florida legislation[5] and § 3607 are set forth below:

Fla. Stat. § 719.302(1)	15 U.S.C. § 3607
Any grant or reservation made by a cooperative document, lease or other document, and any contract made by an association prior to assumption of control of the association by unit owners other than the developer, *that provides for operation, maintenance, or management of a cooperative association or property serving the unit owners of a cooperative. . . .*	Any contract . . . which *provides for operation, maintenance, or management* of a condominium or cooperative association in a conversion project, *or of property serving the condominium or cooperative unit owners* in such project. . . .

(emphasis added).

Thus, the Florida statute, after which Congress patterned the Abuse Relief Act, proscribes leases, as well as any other type of reservation of a real property interest by a developer of "property serving the unit owners." When Congress eliminated the language concerning leases and other types of real property interests, it clearly evidenced its intent not to regulate such interests.

However, as interpreted by the Second Circuit, the Abuse Relief Act applies to the reservation of a property interest in a lease, but not to other, more significant, reservations of property rights. A developer could, for example, simply reserve a fee interest in property otherwise subject to the statute, and create either a condominium or a tenancy in common with the association or its unit owners. Under such an arrangement, the parties would have the right to enjoy their respective estates forever, instead of for a term of years. There is, and could be, no "contract" between the association and the developer. The developer

[5] The Florida legislation has two separate operative sections, one dealing with condominiums, Fla. Stat. § 718.302(1), and one for cooperatives, Fla. Stat. § 719.302(1). They are identical in all material respects; the section dealing with cooperatives is set forth above.

or sponsor simply would not convey all of its interest in the property to the association and would keep part of what it owns. Since the outbreak of litigation over the Abuse Relief Act in 1985, that is precisely how cooperatives and condominiums are converted if the developer wants to retain part of what it owns.

Thus, according to the Second Circuit's analysis, the developer's reservation of a fee interest forever, with no payments to the association, is not subject to statutory control, while the developer's reservation of a leasehold interest, for a term of years and with payments to the association, is subject to the statutory scheme. This situation is completely irrational, and that is why the Florida legislature, which found the reservation of real property interests to be a matter of legislative concern, attacked the reservation of *all* such interests, and not merely the reservation of a leasehold estate. But had Congress intended to attack the reservation of such interests, it would have done so effectively by simply copying the operative language of the Florida statute.

The Second Circuit's decision is already imposing serious social costs on both developers and tenants in ways that Congress never envisioned. As the Second Circuit's opinion reflects, the conversion in this case was the subject of hard bargaining, which is a commøn occurrence not only in New York City but wherever tenants are in place at a conversion. The Second Circuit has, in effect, told parties to future conversions that they may not bargain for leasehold estates in certain condominium or cooperative related property. The example at issue here is the leasehold of a 150 car garage. As a result, the developer must either sell more of the building to the tenants, and charge a higher price for the units, or reserve more than a leasehold estate. The parties to the conversion, however, if left to bargain on their own, may well prefer a lease to the other two alternatives; indeed, a lease gives the cooperative much more control over the use of the property than the sponsor's reservation of a fee interest.

The Second Circuit's opinion unjustly prevents parties from making these choices. A more rational interpretation of the statute is available: namely, that § 3607 does not apply to leases. We respectfully submit that the Second Circuit committed a serious error in failing to hold otherwise.

That error affects the rights of parties in thousands of conversions already accomplished, and in those which will come throughout the nation.

II. The Termination Provision of § 3607 is Inapplicable Where State Law Prevents the Developer From Exercising the Requisite "Special Developer Control."

Section 3607 of the Abuse Relief Act sets out certain requirements which a "contract" must fulfill before it can be terminated pursuant to a vote of the condominium or cooperative unit owners. One of these requirements, found in § 3607(a)(3), is that a "contract" has been "entered into while such association was controlled by the developer through special developer control." [6]

Special developer control is defined in § 3603(22) of the Abuse Relief Act as "any right arising *under State law* ... through which the developer may control or direct the unit owners' association or its executive board." (emphasis added). Where, as here, State law prohibited the developer from converting the building, and thereby obtaining execution of the contract pursuant to terms that the developer had unilaterally determined, the requisite special developer control was missing.

As the Second Circuit recognized, state law prevented the developer from going forward with the conversion, and entering into the leases, until the parties had agreed to the terms of the conversion. The developer originally tried to convert the building pursuant to an "eviction plan" which would have required, under the New York State Martin Act, the agreement of at least 35% of the tenants in occupancy of the units. (JA 18-19 n.3). When such approval could not be obtained here, the plan was changed to a "non-eviction" plan, which requires 15% consent, or 65 of 429 units, before the plan could be declared effective. N.Y. Gen.

[6] An alternative showing to "special developer control" permitted by § 3607(a)(3) of the Abuse Relief Act, is that the "contract" was entered into while the association was controlled by the developer "because the developer held a majority of the votes in such association." That provision is not applicable to this case because no stock was issued in the cooperative corporation until after the closing. (JA 451).

Bus. Law § 352-eeee(1)(b). (JA 18-19). Here, the developer could not even achieve that percentage, and was thus compelled to negotiate.

The result of these negotiations was substantially better terms and conditions than those provided by the initial offering plan. The price of an apartment was reduced by over 40 percent, from an original purchase price of $80.00 per share to a negotiated final purchase price of $49.90 per share. (JA 20). Thus, a typical two-bedroom apartment which would have cost tenants in occupancy $85,900 under the original offer, would be sold to such insiders for $53,592.60. (*Id.*).

The tradeoffs in the negotiations also included substantial increases in the rentals to be paid to the cooperative under the two leases. The base rent for the first five years of the commercial lease increased to $80,000 from the $50,000 proposed in the initial offering plan, with a final rent under the lease of $95,000, up from $65,000. (JA 19-20, 29, 121-22). The rent for the garage lease also increased, from $25,000 per year in the original plan to $44,000, with a final annual rent of $50,000. (JA 20, 40-41, 117).

The foregoing demonstrates that the subject leases were not executed unilaterally by the developer or by an entity controlled by the developer through "special developer control." Just as state law can vest the sponsor with special developer control, the law can take that control away. Here, the developer could not have converted the building without the consent of 15% of the units, as required by the Martin Act. Since state law took away the sponsor's control over the conversion process, the sponsor did not possess the requisite "special developer control." [7]

Like the District Court, the Second Circuit focused almost exclusively on the relevance of the negotiations to the issue of

[7] Even after agreement with the tenants on the terms of the conversion had been reached, the sponsor could not convert the building until it obtained the consent of the United States Department of Housing and Urban Development ("HUD"), which had insured the mortgage on the premises. (JA 455-56). Accordingly, the sponsor submitted the terms of the conversion, and all the documents related thereto, including the leases at issue, to HUD for its review and approval. (*Id.*). This review process, which took over six months to complete, resulted in changes to the leases at issue here. (*Id.*).

the statute's application. The Second Circuit found no basis in the statute to support the argument that the existence of negotiations between the tenants and the sponsor was relevant. However, the Second Circuit, like the District Court, asked the wrong question. The crucial issue is not whether the parties negotiated, or what they said to each other in their negotiations. The issue posed by the statute is instead whether the sponsor had the power unilaterally to determine the terms of the agreement. In this case, as is true in many jurisdictions with statutory tenant protections, the sponsor had no such power.

The Second Circuit not only asked the wrong question. It also failed to understand the nature of the cooperative conversion process, and the extent to which Congress intended to regulate that process. For example, the Second Circuit in its analysis cited to a Congressional concern that tenants not be enticed to buy their apartments at an "artificially low insider price" established through negotiations with a developer. 815 F.2d at 201 (App. A., *infra*, 25a). There is no evidence in the legislative history that Congress raised that concern, and it would be rather surprising if it had. The price that the parties establish for an apartment was of no particular concern to Congress — as long as the developer could not impose the terms unilaterally upon the tenants. Here, both sides were guided by experts throughout the conversion process. If the tenants desired lower prices for their apartments at the expense of higher maintenance payments over the long run, that was their choice to make. Such a choice would enable less affluent tenants to become property owners — a result which should be encouraged, not condemned. The Second Circuit has, in effect, told parties to future conversions that they may not make that choice.

By making the existence of "special developer control" one of the statutory tests for the applicability of § 3607, Congress intended that courts examine whether the sponsor could convert a building unilaterally. Where the sponsor lacks control over the conversion, there is no danger that the abuses which Congress sought to prevent could occur. Here, because the entire conversion was free from unilateral control by the developer, the parties were free to strike an arrangement that suited their own interests. By making the statute applicable to conversions where

the sponsor lacked that power, out of a misguided concern for "artificially low" insider prices, the Second Circuit limited the freedom of future tenants and developers to establish freely negotiated prices in a conversion. That judgment certainly grants the cooperative a windfall in this case. However, as we have previously demonstrated, the decision also imposes social costs on parties to future conversions. For this reason, the decision of the Second Circuit should be reversed.

CONCLUSION

For the foregoing reasons, petitioners respectfully submit that the writ should be granted.

Respectfully submitted,

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June 12, 1987

APPENDIX

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 27 — August Term, 1986

(Argued August 25, 1986 Decided March 18, 1987)

Docket No. 86-7210

WEST 14TH STREET COMMERCIAL CORP.,
WEST 14TH STREET GARAGE CORP., AND
WEST 14TH STREET LAUNDRY CORP.,

Plaintiffs–Appellees,

v.

5 WEST 14TH OWNERS CORP.,

Defendant–Appellant.

Before:

FEINBERG, Chief Judge, CARDAMONE, Circuit Judge,
and KELLEHER, District Judge.*

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5 West 14th Owners Corp. appeals from a judgment entered in the United States District Court for the Southern District of New York (Knapp, J.) which denied its motions for summary judgment or dismissal of plaintiffs' West 14th Street Commercial Corp., *et al.*, complaint in a declaratory judgment action.

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* Honorable Robert J. Kelleher, Senior United States District Judge for the Central District of California, sitting by designation.

Appendix A

Defendant–appellant's motion was made on the grounds that plaintiff's complaint sought to enforce contracts that it had lawfully terminated under the provisions of the Condominium and Cooperative Conversion Protection and Abuse Relief Act, 15 U.S.C. §§ 3601-16 (1982). The district court declared appellant's purported termination void and granted summary judgment in favor of plaintiffs.

Affirmed in part; reversed in part and remanded.

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Appendix A

CARDAMONE, Circuit Judge:

This appeal requires us to construe the Condominium and Cooperative Conversion Protection and Abuse Relief Act, 15 U.S.C. § 3601—16 (1982) (Act), enacted to protect the rights of tenants whose residential apartment buildings are converted to cooperatives or condominiums. Realizing that many tenants are too unsophisticated on account of age or infirmity to evaluate properly the complex choices offered them upon conversion, Congress sought to alleviate developer abuses during the conversion process. At the same time Congress recognized that developers deserve a fair return on their investment. Yet when a developer's profit is unconscionable, it comes at the tenants' expense. Thus, the scope of the Act must be determined in light of these concerns.

BACKGROUND

In 1982 Parker 14th Associates (Parker or the developer) sought to convert its apartment building located at 5-19 West 14th Street in New York City to a cooperative form of ownership. Believing the offering plan to be unfair, the tenants banded together and signed a no-buy pledge agreement. Later, they negotiated with the developer for a year over the details of the conversion, the plan became effective and title to the building was transferred to 5 W. 14th Owners Corp., the cooperative association owned by the tenant-shareholders. Owners Corp. now owns the building and is the defendant-appellant in this action.

As part of the negotiated conversion plan, Owners Corp. — while still managed by directors appointed by the developer — signed three long-term contracts that assigned profitable rights to the plaintiffs-appellees, three developer-affiliated corporations, West 14th Street Commercial Corp., West 14th Street Garage Corp. and West 14th Street Laundry Corp. The instant suit was precipitated when a tenant-controlled board took over Owners Corp. and, under the authority of the Act, purported to

terminate the three contracts negotiated by the tenants' organization.

A. *The Conversion*

After Parker — the owner of the subject high-rise multiple residence building at Fifth Avenue and 14th Street in Union Square — decided to convert the building to a cooperative, it filed an Offering Plan in 1982 that included the three contracts in question. In response the tenants organized the P.G. Tenant's Unity Group (Unity Group) and collected no-buy pledges from over 65% of the tenants. These actions deprived the developer of the number of inside buyers it needed to evict non-buying tenants under New York's Martin Act, N.Y.Gen.Bus.Law § 352-eeee (McKinney 1984), amended by 1982 N.Y. Laws c. 555 § 2. Parker then proposed a non-eviction plan which, to become effective under the Martin Act, required that 15% of the insiders purchase their apartments. *Id.* Obtaining subscriptions from only 4% of the tenants, the developer was forced into negotiations with Unity Group.

Although they now dispute the nature and extent of these negotiations, the two sides met several times during the year, filed amendments to the Offering Plan, and made material changes in all three contracts. The developer stated in the record that it "remained completely adamant" that the laundry, garage and commercial space be leased back to it as part of the conversion plan. It negotiated only as to the rent it would pay. There is evidence that the Unity Group and Parker reached at least a tentative agreement on these leases, which was communicated to the tenants in a newsletter and at a meeting. By January 6, 1984 when the Plan was declared effective, 36% of the units had committed to purchase and by the end of January 85% of the tenants had purchased. On August 28, 1984, a week before the closing, the three contracts were sent to Unity Group's attorney for comments. On September 6, 1984, with Unity Group representatives present, the closing was held at which all three of the contracts in question were signed. At that time defendant Owners Corp. was still under the legal control of directors appointed

by the developer, and the closing documents were signed for all parties by persons associated with the developer.

B. *The Contracts*

The three contracts at issue are the Master Commercial Lease, the Parking Garage Lease, and the Laundry Concession.

1. *The Master Commercial Lease*

Owners Corp., after replacing the developer as landlord, leased space to plaintiff 14 West Commercial Corp. in the building for four commercial retail stores. The lease ran for a period of 20 years, with a 20-year option to renew. The rent was admittedly well below market, providing plaintiff Commercial Corp. with an opportunity to sub-let the property at a substantial profit. This additional profit potential was acknowledged in the "Special Risks" point of the Offering Plan. Owners Corp. remained responsible for providing water, utilities and insurance over the lease term and was obliged to absorb any increase in these expenses. The retail stores were to be open to the general public.

2. *The Parking Garage Lease*

Plaintiff 14 West Garage Corp. leased the parking garage space in the building's basement and cellar from Owners Corp. This lease also ran for 20 years at admittedly below market rent with a similar renewal option. Although the parking garage was open to the general public, unit holders leased about one-third of the spaces and the Garage Corp. had an obligation — stated in the Offering Plan — to give building residents first preference when spaces became vacant. The garage lease included a covenant that the space be used only as a parking garage, and set forth the understanding of the parties that the service of a parking garage was an "integral part of the operation of a high-class multiple dwelling."

3. *The Laundry Concession*

Owners Corp. also entered into an agreement with 14 West Laundry Corp. for the latter to provide coin-operated washing machines and dryers in the building's laundry room and receive the income from those machines for the next 20 years in return for paying the cooperative $1,500 per month. The laundry room serves the building's residents and is not open to the general public.

C. *The Termination and Proceedings Below*

On October 10, 1984 a meeting of the shareholders of Owners Corp. was held at which officers and directors independent of the sponsor were elected. The outgoing Board requested, but was denied, a ratification of all prior corporate acts. On June 12, 1985, in accordance with § 3607 of the Act, a meeting of the shareholders was held at which a resolution was passed — by more than the statutorily required ⅔ majority — to terminate the three described contracts. On July 3, 1985 Owners Corp. served upon plaintiffs the statutorily required 90 day notice of termination. Plaintiffs immediately filed this declaratory judgment action and sought injunctive relief in the United States District Court for the Southern District of New York (Knapp, J.). The district court declared Owners Corp.'s termination of the contracts void and granted plaintiffs' motion for summary judgment holding that the challenged contracts fell outside the scope of the Act. It also denied defendant's motions for summary judgment or dismissal of plaintiffs' complaints. From the district court's opinion and judgment, 625 F. Supp. 934 (S.D.N.Y. 1986), Owners Corp. appeals.

DISCUSSION

I FEDERAL QUESTION JURISDICTION

Owners Corp. argues for the first time on appeal that the district court lacked subject matter jurisdiction. Because all the

parties are New York corporations, if jurisdiction is to be found it must rest upon 28 U.S.C. § 1331 (1982) which grants jurisdiction to federal district courts for civil actions "arising under" federal law.

To define what constitutes federal question jurisdiction, it is helpful to analyze the subject in historical perspective. Under the Constitution federal question jurisdiction was originally very broad. Chief Justice Marshall, commenting on the constitutional provisions of Art. III § 2[1] in *Osborn v. Bank of United States*, 9 Wheat. 738, 22 U.S. 326 (1824), stated that "[w]hen a question to which the judicial power . . . extend[s] . . . forms an ingredient of the original cause, it is in the power of congress to give the circuit courts jurisdiction of that cause, although other questions of fact or of law may be involved in it." 9 Wheat. at 823, 22 U.S. at 362. Later, as a result of a statutory enactment, access to a federal forum was restricted. Judiciary Act of 1875, Act of March 3, 1875, ch. 137, § 1, 18 Stat. 470. Section 5 of that Act directed a federal court to dismiss or remand a suit if it appeared at any time "that such suit does not really and substantially involve a dispute or controversy properly within [its] jurisdiction." There is wide agreement that the statute narrowed the path, *see, e.g., Romero v. International Terminal Operating Co.*, 358 U.S. 354, 379 (1959), but defining that path's precise boundaries has often proved to be a Sisiphyean task.

There are two tests under which an action may present a federal question. The first asks whether federal law creates the cause of action. If so, federal question jurisdiction exists. In *American Well Works Co. v. Layne & Bowler Co.*, 241 U.S. 257 (1916), Justice Holmes devised this still relied upon rule writing that "[a] suit arises under the law that creates the cause of action." *Id.* at 260; *see also The Fair v. Kohler Dye & Specialty Co.*, 288 U.S. 22, 25 (1913).

If state law creates the cause of action, the second test asks whether that cause of action poses a substantial federal question. The lineage of this second test of "arising under" jurisdiction reaches back 65 years to *Smith v. Kansas City Title & Trust Co.*, 255 U.S. 180, 201 (1921). In that case, plaintiff sought to enjoin defendant corporate officers from investing corporate

funds in farm loan bonds issued by federal land banks because the act authorizing their issue was unconstitutional — and hence constituted an investment in an unlawful security under Missouri law. The Supreme Court found federal jurisdiction present because of the necessity to decide the constitutional issue as an element of the state law claim.

In determining whether the complaint presents a federal question, the court must examine it in accordance with the well-pleaded complaint rule. Posited 13 years after the 1875 Act in *Metcalf v. Watertown*, 128 U.S. 586 (1888), this rule states that federal jurisdiction must be found from "what necessarily appears in the plaintiff's statement of his own claim . . . , unaided by anything alleged in anticipation of avoidance of defenses which it is thought the defendant may interpose." *Taylor v. Anderson*, 234 U.S. 74, 75-6 (1914); *see also Louisville & Nashville Ry. v. Mottley*, 211 U.S. 149 (1908). This "powerful doctrine", *Franchise Tax Board v. Construction Laborers Vacation Trust*, 463 U.S. 1, 9 (1983), remains the initial reference by which a federal court must determine whether there is "arising under" jurisdiction. *See Merrell Dow Pharmaceuticals, Inc. v. Thompson*, __ U.S. __, 106 S. Ct. 3229, 3232 (1986). Examining only those allegations which are properly raised in a well-pleaded complaint, the court must then determine whether the substance of those allegations raises a federal question.

Recently, the Supreme Court reaffirmed its adherence to the "well-pleaded complaint" rule and to the two tests for "arising under" jurisdiction just described. Emphasizing that any federal issue raised in a non-federal cause of action must be really substantial, the Court warned, "the mere presence of a federal issue in a state cause of action does not automatically confer federal question jurisdiction." *Merrell Dow*, 106 S. Ct. at 3235 (footnote omitted); *see also Gully v. First National Bank*, 299 U.S. 109, 116 (1936) (where in a state cause of action "the federal nature of the right to be established is decisive" there is a substantial federal question) (quoting *Puerto Rico v. Russell & Co.*, 281 U.S. 476, 483 (1933)). To determine when the federal element is deemed sufficiently substantial we must look to the

nature of the federal interest at stake. *Merrell Dow*, 106 S. Ct. at 3236 n.12. *Merrell Dow* held that when Congress has provided no private right of action under a federal statute, the borrowing of that federal law as a standard of conduct in a state created action is not sufficiently substantial to confer federal question jurisdiction.

In short, not every case or cause of action that knocks on the federal courthouse door gains entrance. To determine whether the court has federal question jurisdiction to decide the case, the complaint must contain either a federal cause of action or a state cause of action embodying a substantial federal question. With this formula in mind, we turn to the jurisdictional question.

II APPLICATION TO INSTANT CASE

Applying the above rules to the facts of the present case, we conclude that because one section of the Act, 15 U.S.C. § 3611, expressly grants plaintiffs the right to bring an action in federal court under § 3607, the provision of the Act that authorizes termination of self-dealing contracts, plaintiffs' well-pleaded complaint presents a federally-created cause of action. Alternatively, we hold that even if plaintiffs have no statutorily created federal action under § 3607, their state claims encompass a substantial federal question under the Condominium and Cooperative Conversion Protection and Abuse Relief Act. We further conclude that either finding is sufficient to establish "arising under" jurisdiction.

A. *Federal Cause of Action*

15 U.S.C. § 3611 provides in relevant part:

> Suits at law or equity
>
> (a) Unless otherwise limited as in section 3607 or 3608 of this title, any person aggrieved by a violation of this chapter may sue at law or in equity.

Recovery of actual damages

(b) In any action authorized by this section for a violation of section 3607 or 3609 of this title where actual damages have been suffered, such damages may be awarded or such other relief granted as deemed fair, just, and equitable.

Based on this provision, plaintiffs' three developer-affiliated corporations seek a declaration that defendant's termination of the three contracts was not authorized by § 3607 and was, therefore, void. The complaint asserts subject matter jurisdiction in federal court under both 28 U.S.C. § 1331 and 15 U.S.C. § 3612. The latter gives the federal courts jurisdiction to hear "actions at law or in equity brought under [The Condominium and Cooperative Abuse Relief Act of 1982] without regard to the amount in controversy." Thus, the allegations of the complaint alone — under the well-pleaded complaint rule — reveals that plaintiffs' cause of action is a direct product of § 3607, 3611, and 3612.

Defendant Owners Corp. argues that neither party has an "action at law or equity" under § 3607 because the statute was intended to furnish a "non-judicial" remedy. *See* S. Rep. No. 736 96th Cong., 2d Sess. 51, *reprinted in* 1980 U.S. Code Cong. & Ad. News 3506, 3558. But § 3611(b) refers to "any action authorized by this section for a violation of section 3607." Hence, even a cursory reading of the statute demonstrates that defendant's contention is without merit. Further § 3611(a) grants a private right of action to "any person aggrieved by a violation of this chapter." We conclude that plaintiffs were so aggrieved. In essence, plaintiffs claim that Owners Corp. wrongfully terminated their contracts under the auspices of § 3607. If Owners Corp.'s termination under § 3607 was not lawful, plaintiffs have been aggrieved by Owners Corp.'s misapplication of the statute.

Legislative history supports this conclusion. The Senate version of § 3611 had originally provided for a civil remedy only by

"one or more purchasers, or by a tenants' organization or an owners' association" against "[a] developer or his successor or agent" S. Rep. No. 736 at 78, *reprinted* in 1980 U.S. Code Cong. & Ad. News at 3585. The Conference version amended this provision to give a remedy to "any person aggrieved by a violation of this chapter." The amendment plainly indicates that Congress did not limit the right to sue under this statute merely to aggrieved tenants. Moreover, the general purpose of the Act to provide federal relief in an area traditionally reserved to the states coupled with an explicit grant of federal jurisdiction strongly suggests a Congressional purpose to resolve all § 3607 disputes under federal law. It would make little sense to relegate developers to a state law remedy when the actions complained of are taken under the authority of a federal statute. Consequently, plaintiffs, as aggrieved persons, have a right of action expressly provided in § 3611 that supports the exercise of federal subject matter jurisdiction. *See Merrell Dow*, 106 S. Ct. at 3232-33.

B. *State Cause of Action Presenting a Substantive Federal Question*

Even if plaintiffs had no express right of action under the statute, their complaint would still present a federal question sufficient to confer jurisdiction under 28 U.S.C. § 1331. That complaint seeks a declaration "that the termination of the leases by Owners Corp. is of no force and effect" because the statutory authorization under § 3607 does not encompass the three contracts at issue or, in the alternative, if the statute applies, that it is unconstitutional. Plaintiffs also sought an injunction against future terminations by Owners Corp. and damages.

Defendant urges that the complaint simply sets forth a state-law claim for breach of contract, with the federally authorized termination asserted only as an anticipated defense. Plaintiffs respond that its declaratory judgment complaint raises a federal question. We note at the outset that federal jurisdiction cannot be based on the fact that a declaratory judgment is sought because the declaratory judgment statute does not expand the jurisdiction of the federal courts. *Skelly Oil Co. v. Phillips*

Petroleum Co., 399 U.S. 667, 671 (1950). Instead, a court must look beyond the declaratory judgment allegations and determine whether a substantial federal question arises either from the defendant's threatened action, *Franchise Tax Board*, 463 U.S. at 16 & n.14; *Public Service Commission v. Wycoff Co.*, 344 U.S. 237 (1952), or from the complaint when viewed as a request for coercive relief apart from the defendant's anticipated suit. *Stone & Webster Engineering Corp. v. Ilsley*, 690 F.2d 323, 327-28 (2d Cir. 1982), *aff'd.*, 463 U.S. 1220 (1983). Under either approach plaintiffs have a cause of action that arises under federal law.

1. *Defendant's Threatened Action*

The first approach analyzes an action that would have been brought by the declaratory judgment defendant. In *Franchise Tax Board*, the Supreme Court stated that

> Federal courts have regularly taken original jurisdiction over declaratory judgment suits in which, if the declaratory judgment defendant brought a coercive action to enforce its rights, that suit would necessarily present a federal question.

463 U.S. at 19. The developer-affiliated plaintiff corporations argue that the declaratory judgment defendant, Owners Corp., was threatening to and could have brought a federal action under § 3607. Because plaintiffs were anticipating a federal suit, they claim that their declaratory judgment action presents a federal question. Owners Corp. responds that it need not have brought a federal suit, but could have sued in state court in trespass, ejectment, or contract.

Although there is no meritorious contract action available to Owners Corp., it is true that it could have brought a state action in trespass or ejectment. But, a well-pleaded complaint under either of these theories would have to set forth Owners Corp.'s current right to possession. *Oneida Indian Nation v. County of Oneida*, 414 U.S. 661, 666 (1974) (ejectment); *New York v.*

White, 528 F.2d 336 (2d Cir. 1975) (same); *Donohue v. Whitney*, 133 N.Y. 178 (1892) (trespass); *Firment v. Bryden*, 54 A.D.2d 796 (3d Dep't 1976) (same). And, because Owners Corp.'s "current right to possession [is allegedly] conferred by federal law" under the authority of § 3607, a well-pleaded complaint alleging these state law possessory actions would necessarily raise a federal question. *Oneida Indian Nation*, 414 U.S. at 666.

Owners Corp. further contends that it need not have sued under § 3607 but could have locked-out plaintiffs and their subtenants forcing them to initiate coercive legal action. Yet, under *Franchise Tax Board* the question is not whether the declaratory judgment defendant would necessarily bring a federal action, but rather *if it brought an action* would such action necessarily have raised a federal question. Although defendant might have regained possession of the property through self-help remedies, it could not have disposed of the legal dispute without judicial resolution of the propriety of its actions under § 3607; hence in bringing suit it would have created federal question jurisdiction for the issues in dispute.

2. *The Complaint As Coercive Relief*

The second approach leads to the same conclusion. In addition to examining defendant's "threatened" action, we examine plaintiffs' complaint to see if it raises a federal question when viewed as a coercive action apart from defendant's anticipated suit. *Stone & Webster*, 690 F.2d at 327-28. To do this, it is necessary to identify the substantive theory upon which plaintiffs could have brought their cause of action to determine whether the federal issue would arise under a "well-pleaded" complaint.

Although there is some discretion when construing plaintiffs' complaint, *New York State Waterways Assoc. v. Diamond*, 469 F.2d 419, 421 (2d Cir. 1972), federal jurisdiction may not rest on an equitable claim when an adequate remedy at law that would not confer such jurisdiction is available. *White*, 528 F.2d at 338. No legal remedies adequately fit plaintiffs' complaint. There is no action for trespass or ejectment because plaintiffs

are in possession or constructive possession (through subtenants) of the real property, *see White*, 528 F.2d at 338-39. Nor would a contract action be appropriate because plaintiffs seek to retain possession of the property under the leases rather than merely obtain damages. Thus, we assume that whatever state claim plaintiffs have is equitable in nature.

Viewing the complaint as an equitable action seeking coercive relief, it may properly be considered as a common law or statutory action to remove a cloud on title. Under *Hopkins v. Walker*, 244 U.S. 486 (1917), "the existence and invalidity of the instrument or record sought to be eliminated as a cloud upon the title are essential parts of the plaintiff's cause of action." 244 U.S. at 490. Consequently, since it is the provisions of § 3607 that give rise to the cloud, the statute must necessarily be pleaded in a well-pleaded action to remove that cloud. *Hopkins*, 244 U.S. at 491; *White*, 528 F.2d at 339. Thus considered as a common law action, the complaint necessarily raises a substantial federal question on the face of a well-pleaded complaint.

This conclusion is no different under a modern statutory action. New York has codified the common law action to quiet title and statutorily redefined the necessary elements for a well-pleaded remaining cloud on title complaint. Under Article 15 of the Real Property Actions and Proceeding Law, the plaintiff need only plead its claim to an estate or interest in land and defendant's adverse claim; plaintiff need not plead the "invalidity" of defendant's claim as required under the common law. N.Y. Real Prop. Acts Law § 1515.1 (McKinney 1979).[1] Plaintiffs' well-pleaded complaint under the quieting title statute would have to allege defendant's adverse claim under § 3607 and would therefore raise a federal question. Consequently, under either the common law or statutory formulation federal question jurisdiction would necessarily arise in a well-pleaded complaint.

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1. Although § 1515.1 provides that "[t]he complaint must state that the action is brought pursuant to this article," N.Y.Real Prop. Acts. Law § 1515.1 (McKinney 1979), the New York Court of Appeals has held that the fact that the plaintiffs do "not refer to the article or use the language of the statute is not a fatal defect." *Howard v. Murray*, 38 N.Y.2d 695, 699-700 (1976).

3. *Substantial Federal Question*

Merrell Dow teaches that the above discussion — showing that a federal question appears on the face of a well-pleaded complaint — is not sufficient to demonstrate the existence of "arising under" jurisdiction. One final question remains: whether the federal issue arising in the state law cause of action is sufficiently "substantial" to confer federal-question jurisdiction. *Merrell Dow*, 106 S. Ct. at 3236. In this inquiry, "the nature of the federal issues at stake," *id.* at 3236 n.12, with an eye to "practicality and necessity," *id.* at 3234, must be analyzed. In *Merrell Dow*, the Supreme Court looked at substantiality with narrowed eyes holding that where Congress has not provided plaintiff with a private right of action under a federal statute, it must be concluded "that the presence of a claimed violation of the statute as an element of a state cause of action is insufficiently 'substantial' to confer federal-question jurisdiction." *Id.* at 3236.

Nonetheless, assuming that plaintiffs have no private right of action under § 3607, we conclude that the federal element in plaintiffs' state cause of action would still be sufficiently substantial to confer arising under jurisdiction. In *Merrill Dow* the federal statute was merely incorporated by reference as a standard of conduct in a state negligence action. Here the situation is quite different. In construing the Condominium Relief Act in a state cause of action, the federal issue is decisive because upon that Act's construction the vindication of rights and definition of relationships *created by federal law* depends. *See Gully*, 299 U.S. at 116. In light of this qualitative difference, the federal ingredient in plaintiffs' complaint in this case is sufficiently substantial to confer the arising under jurisdiction. Having found federal jurisdiction, we proceed to the merits.

III REQUIREMENTS OF § 3607(a) MET

Plaintiffs argue that the three terminated contracts do not fall within the scope of § 3607(a). This section gives the coop-

erative association the right to terminate contracts which provide for (1) "the operation, maintenance, or management of a ... cooperative association ... or of property serving the ... cooperative unit owners," and are (2) between the unit owners and developer, (3) which were entered into while the cooperative association was controlled by the developer, (4) and are for a period of more than three years. 15 U.S.C. § 3607 (1982).[2]

All four of these statutory elements must exist for a contract to fall within reach of the Act. The district court concluded that the contracts did not satisfy the elements of subdivisions (2) and (3) and therefore could not lawfully be terminated under § 3607. The district court reasoned that the negotiations between the parties rendered the remedial provisions of the Act unavailable to Owners Corp. Because it is conceded that all the contracts were for more than three years, subdivision (4) was not discussed.

On appeal, defendant asserts that the four subdivisions of § 3607 have been met. Although plaintiffs concede that the laundry room concession is subject to § 3607 of the Act, they

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2. Section 3607 provides in pertinent part:

Operation, maintenance, and management contracts; penalty

(a) Any contract or portion thereof which is entered into after October 8, 1980, and which—

(1) provides for operation, maintenance, or management of a condominium or cooperative association in a conversion project, or of property serving the condominium or cooperative unit owners in such project;

(2) is between such unit owners or such association and the developer or an affiliate of the developer;

(3) was entered into while such association was controlled by the developer through special developer control or because the developer held a majority of the votes in such association; and

(4) is for a period of more than three years, including any automatic renewal provisions which are exercisable at the sole option of the developer or an affiliate of the developer,

may be terminated without penalty by such unit owner or such association.

15 U.S.C. § 3607 (1982).

argue that the garage and commercial leases — in addition to not meeting subdivisions (2) and (3), as the district court concluded — do not satisfy the elements of subdivision (1) either. Plaintiffs contend that these two leases do not involve "property serving" unit holders, and that the instruments in question are "leases" subject to § 3608 of the Act, not "contracts" within § 3607. In the discussion that follows, we take up all of these contentions.

— Subdivision (1) of § 3607(a) —

Contracts Which Provide for Operation, Maintenance or Management

In attempting to establish that the garage and commercial leases are not "contracts" for the purposes of § 3607, plaintiffs claim that the problem of unconscionable *leases* was addressed by § 3608.[3] Since § 3608 allows the termination of leases only

3. Section 3608 provides in pertinent part:

Lease characteristics; authorization by unit owners; conditions precedent to action

(a) Cooperative and condominium unit owners through the unit owners' association may bring an action seeking a judicial determination that a lease or leases, or portions thereof, were unconscionable at the time they were made. An action may be brought under this section if each such lease has all of the following characteristics:

(1) it was made in connection with a cooperative or condominium project;

(2) it was entered into while the cooperative or condominium owners' association was controlled by the developer either through special developer control or because the developer held a majority of the votes in the owners' association;

(3) it had to be accepted or ratified by purchasers or through the unit owners' association as a condition of purchase of a unit in the cooperative or condominium project;

(4) it is for a period of more than twenty one years or is for a period of less than twenty-one years but contains automatic renewal provisions for a period of more than twenty-one years;

after the cooperative satisfies stringent limitations not present in § 3607, plaintiffs argue that an interpretation of § 3607 which includes leases would render these limitations ineffective. They also urge that a lease is a transfer of an estate in land, not a contract for operation maintenance or management and, therefore, beyond the scope of § 3607.

These arguments are flawed on a number of grounds. First, a "lease" as used in § 3608 is defined narrowly to include only property owned by the developer (or developer affiliated companies) leased *to* the cooperative project; not, as here, cooperative property leased *by* the cooperative to the developer. § 3603. Hence, the limitations of § 3608 are not undercut if § 3607 is construed to apply to leases where the cooperative association is the lessor.[4] Second, legislative history reveals that leases as well as contracts are covered by § 3607. For example, Senator Williams, the bill sponsor, described § 3607 as a method for residents to void "a long-term self-dealing *leasing arrangement*." 126 Cong. Rec. 28,178 (1980) (emphasis added). The Senate Report also refers to "lease provisions" in discussing § 3607. S. Rep. No. 736, 96th Cong., 2d Sess. 95, *reprinted in* 1980 U.S. Code Cong. & Ad. News 3601 (Additional Views of Senators Garn, Lugar, Tower and Armstrong). Third, a line drawn between leases and contracts would exalt form over substance. Leases, a species of contract, may contain covenants that require the lessee to perform certain contractual services for the landlord. For instance, both leases in this conversion contain affirmative covenants: the plaintiff garage tenant covenanted to "use and occupy the Demised Premises as a storage garage for . . . automobiles" and to give first preference to the cooperative

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(5) it contains an automatic rent increase clause; and

(6) it was entered into prior to June 4, 1975.

15 U.S.C. § 3608 (1982).

4. We see nothing anomalous in interpreting § 3607 to apply to leases of cooperative owned property to a sponsor affiliated company but not to leases which run in the other direction. Where the sponsor leases developer-owned facilities to the cooperative, it can hardly be said to be managing, maintaining, or operating that property for the cooperative, absent an explicit reservation of those responsibilities.

residents; the plaintiff commercial tenant covenanted to "use and occupy the demised premises for sale of retail goods to the public." Thus, a lease, in substance, may be nothing more than a contract of operation.

Finally, construing this statute so as to permit cooperatives to cancel only maintenance-type contracts, but not leases would, contrary to Congress' aim, serve as an incentive to developers to try and retain as much control over cooperative property as possible. For example, a *contract* for the operation of a laundry room, where the developer retained a fair percentage of the profits would be terminable, while a *lease* for the same laundry room space where the laundry room-tenant (developer) paid a below market fixed-rent would not be. Such an anomalous result would thwart Congress' plan.

"Property Serving" the Unit-Owners

Plaintiffs also assert that the commercial and garage spaces are not "property serving the . . . cooperative unit owners" for the purpose of § 3607 because they do not *exclusively* serve the residents of the building. We cannot adopt such a narrow reading of this remedial law. The words "exclusive" or "exclusively" do not appear in the statute. Further, such an interpretation would enable developers in future conversion projects to sidestep the statute simply by eliminating the exclusive nature of any service. For instance, by opening a handful of spaces in a private parking lot to the public, or by giving the public access to a heretofore private laundry room, developers could remove their contracts from § 3607's reach.

Because no special meaning was attached to "property serving", we assume instead that Congress did not contemplate one. Consequently, the phrase should be accorded its plain, ordinary meaning of providing services. *Perrin v. United States*, 444 U.S. 37, 42 (1979). In reaching this conclusion we rely on Congress' purpose. Legislative history reveals that the statute was designed to protect those services associated with recreational leases and management contracts, such as the provision for security, general maintenance and repair, elevator service, and the

upkeep of communal areas. *See* 4B R. Powell & P. Rohan, *The Law of Real Property* ¶ 633.35[3], 633.36 (1986) (describing the various services); Krebs, *Legislative Response to "Sweetheart" Management Contracts: Protecting the Condominium Purchaser,* 55 Chi-Kent L. Rev. 319 (1979); Annot., 73 ALR 3d 613 (1976) (collecting and analyzing cases in which contracts challenged on claim of self-dealing); Note, Real Property-Condominiums-Developer Self-Dealing, 1975 B.Y.U. L. Rev. 295. From this history, it is plain that Congress aimed to protect property providing services primarily for the benefit of the unit-owners.

Applying this standard, an on-site parking garage is property providing a service primarily for the benefit of the cooperative. A parking garage, with or without tenant preferences, provides a service that tenants might reasonably expect as an essential adjunct of their apartment complex. In the instant case, a number of factors make it especially clear that the parking garage "serves" the unit-owners. The garage lease contained an affirmative covenant that the garage tenant would use the space to provide a specific service, *i.e.,* the operation of a parking garage. Further, although the garage was open to the public, both the Conversion Offering Plan and the building's certificate of occupancy contain provisions indicating that residents would have first preference for vacant spaces. Finally, the parties in this case set forth in the garage contract their understanding that "the services to be furnished by [the garage tenant] . . . are an integral part of the operation of a high-class multiple dwelling . . . ."

Commercial stores, on the other hand, are primarily for the benefit of the *public.* Although the availability of commercial stores may be deemed to "relate directly to the ease, comfort and economy of the cooperative shareholders," *Phoenix Tenants Association v. The 6464 Realty Co.,* 119 A.D.2d 427, 435 (1st Dep't 1986) (dissenting opinion), they do not serve as an integral benefit to the unit-holders in the same respect as on-site parking.

Concededly, it may be more convenient for unit-owners to have easily accessible banks, cleaners, drug and grocery stores, and the like. But these services are not the sort that a tenant

should reasonably expect as an essential adjunct of an apartment complex. Again, the contracts bolster this conclusion. Clause 1 provides that the "tenant shall use and occupy demised premises for sale of retail goods *to the public* and for no other purpose," and Clause 45A provides that the space "shall be used for retail space and services compatible with similarly situated cooperative apartment buildings *in the general area* of the Building." (emphasis added).

In sum, the garage leasing contract is a contract that provides for the operation, maintenance, or management of "property serving" the cooperative unit owners; but the commercial lease does not so qualify within the meaning of § 3607(a)(1).

— Subdivision (2) of § 3607(a) —

Between the Unit Owners and Developer

The contracts were signed by Parker, a "developer" as defined by § 3603(14)[5] and Owners Corp., a "cooperative association" as defined in § 3603(9).[6] Hence, it seems plain that the contracts

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5. This subsection provides that:

"developer" means (A) any person who offers to sell or sells his interest in a cooperative or condominium unit not previously conveyed, or (B) any successor of such person who offers to sell or sells his interests in units in a cooperative or condominium project and who has the authority to exercise special developer control in the project including the right to: add, convert, or withdraw real estate from the cooperative or condominium project, and maintain sales offices, management offices and rental units; exercise easements through common elements for the purpose of making improvements within the cooperative or condominium; or exercise control of the owners' association . . . .

15 U.S.C. § 3603(14) (1982).

6. This subsection provides that a:

"cooperative association" means an organization that owns the record interest in the residential cooperative property; or a leasehold of the residential property of a cooperative project and that is responsible for the operation of the cooperative project.

15 U.S.C. § 3603(9) (1982).

were "between" the cooperative association and the developer. Nevertheless, the district court held that the contracts — while formally "between" the developer and Owners Corp. — were in reality "between" the developer and the tenants' Unity Group which negotiated the contracts. The district judge therefore held that the contracts could not be avoided by Owners Corp. Realizing that Unity Group could not legally bind Owners Corp., the trial court also concluded that the contracts were "ratified" when 80% of the tenants purchased shares in Owners Corp.

We reach the opposite conclusion. First, a contract is "between" — hence binding on — only those who are parties to it, as evidenced by their signatures. On this ground, only Owners Corp. and the developer as signatories, and not Unity Group, are parties to the contracts. Logically, the contracts could not be "between" Unity Group and the developer because Unity Group is not a party to them. Although ratification could serve to bind Owners Corp. to the contracts, *see* 1A W. Fletcher, *Cyclopedia of the Law of Private Corporations,* § 210(C.V. Swearingen rev. ed. 1983), no ratification took place. That event only occurs upon a vote of the board of directors to adopt the contracts, *id.;* it does not occur through the purchase of stock in the corporation. Thus, the purchase of shares in Owners Corp. by 80% of tenants is irrelevant. In short, because it was only the cooperative Owners Corp. itself that could ultimately bind the cooperative, the contracts must be "between" it and the developer.

— Subdivision (3) of § 3607(a) —

Control by Developer

Again, the contracts easily appear to satisfy the control by developer element of § 3607. Owners Corp. was under "special developer control" when it signed the contracts because it was directed by a board appointed by a developer-affiliate in accor-

dance with the Offering Plan.[7] Although the district court recognized this, it still reasoned that because even an "independent" board would have signed the contracts, the undisputed evidence of developer control should be disregarded. The court believed an independent board would have been compelled to sign the contracts or risk losing the conversion plan.

This focus is misplaced. The crucial inquiry under § 3607 is whether the cooperative was free from developer control when it became obligated under the contracts, not whether an independent board would have signed them. As noted, the evidence that Owners Corp. was under developer control when it signed the contracts is undisputed.

IV NEGOTIATIONS

Having found two of the three contracts to be within § 3607(a), we now address whether the negotiations between Unity Group and the developer render the Act inapplicable. As § 3607's title suggests, it was Congress' purpose to afford relief to unit-holders from the imposition of "self-dealing" or sweetheart developer contracts. The district court found that the contracts in this case were "in no sense 'self-dealing' " because of the negotiations between the parties. 625 F. Supp. at 942. This effort to read negotiations into the statute is misplaced.

In enacting § 3607 Congress provided tenants a non-judicial remedy. The Senate Report on § 3607 — containing but a single sentence — makes the point: "Section [3607] provides a means by which unit owners . . . may terminate a long-term, self-dealing contractual arrangement *without having to resort to judicial action.*" S. Rep. No. 736 at 51, *reprinted in* 1980 U.S. Code Cong. & Ad. News at 3558 (emphasis added); *see also id.* at 95; 1980 U.S. Code Cong. & Ad. News 3600-01 (Additional

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7. "Special developer control" is defined as "any right arising under State law, cooperative or condominium instruments, the association's bylaws, charter or articles of association or incorporation, or power of attorney or similar agreement, through which the developer may control or direct the unit owners' association of its executive board."

15 U.S.C. § 3603(22) (1982).

Views of Senators Garn, Lugar, Tower, and Armstrong). The district court's construction of § 3607 that would allow developers to plead tenant negotiations as a defense to a § 3607 termination would force every termination into litigation. Courts would have to determine, for example, whether the specific contracts were the subject of negotiations and/or whether the parties were bargaining in good faith from roughly equal bargaining positions. Such a result would undermine the legislatively provided non-judicial remedy. Accordingly, we decline to read "a negotiation defense" into § 3607.

This conclusion is further supported by comparing § 3607 to its neighbor § 3608.[8] Unlike § 3607, § 3608(a) specifically provides for "a judicial determination" that a lease was unconscionable after considering several factors including "the commercial setting of the negotiations." § 3608(c)(1); *see also* 126 Cong. Rec. 28,179 (1980) ("[I]t is our intent that courts permit evidence on such matters as the relative bargaining position of the parties.") (statement of Sen. Williams). The absence of these factors in § 3607 persuasively indicates that Congress did not envision negotiations playing a role in the application of § 3607.

As a practical matter, a consideration of negotiations would deter future tenants from engaging in any discussions with

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8. Section 3608(c) provides:

Presentation of evidence after finding of unconscionability

(c) Whenever it is claimed, or appears to the court, that a lease or any portion thereof is, or may have been, unconscionable at the time it was made, the parties shall be afforded a reasonable opportunity to present evidence at least as to —

(1) the commercial setting of the negotiations;

(2) whether a party has knowingly taken advantage of the inability of the other party reasonably to protect his interests;

(3) the effect and purpose of the lease or portion thereof, including its relationship to other contracts between the association, the unit owners and the developer or an affiliate of the developer; and

(4) the disparity between the amount charged under the lease and the value of the real estate subject to the lease measured by the price at which similar real estate was readily obtainable in similar transactions.

15 U.S.C. § 3608(c) (1982).

developers for fear that they would be deemed to have waived their rights under the Act. Moreover, this view of § 3607 is consistent with Congress' desire to protect cooperative apartment owners in that it prevents the developers from offering the tenants a deceptively low purchase price financed by hidden costs spread over a number of years. Congress may have determined that even with effective representation in negotiations, tenants may still be unduly tempted by an artificially low insider purchase price into accepting hidden future costs. There may also have been concern that non-tenant buyers without representation by a tenant's organization might not be informed of concealed costs. Consequently, the existence of negotiations is not a relevant factor in determining whether a termination of a contract satisfies the requirements of § 3607.

CONCLUSION

To summarize: the garage and laundry contracts satisfy all the elements of § 3607 and accordingly could properly be terminated by Owners Corp. At the same time, because the commercial lease is not a contract for the operation, maintenance, or management of property serving the cooperative unit owners, it was improperly terminated by Owners Corp. Accordingly, the district court's grant of summary judgment in favor of plaintiffs insofar as it nullified the Owners Corp.'s termination of the laundry room concession and the parking garage lease is reversed. We remand that portion of the judgment to the district court with directions to enter judgment in favor of appellant Owners Corp. In all other respects, the judgment below is affirmed. All parties shall bear their own costs.

Affirmed in part, reversed in part and remanded.

APPENDIX B

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

WEST 14TH STREET COMMERCIAL CORP.
WEST 14TH STREET GARAGE CORP. AND
WEST 14TH STREET LAUNDRY CORP.,

Plaintiffs,

—against—

5 WEST 14TH OWNERS CORP.,

Defendant.

Memorandum & Order

85 Civ. 5138 (WK)

Appearances

For Plaintiffs:

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Appendix B

WHITMAN KNAPP, D.J.

Three separate but related corporations, West 14th Street Commercial Corporation, West 14th Street Garage Corporation and West 14th Street Laundry Corporation ("plaintiffs"), invoking our jurisdiction to interpret federal statutes, bring this action to enjoin defendant 5 West 14th Street Owners Corporation ("14th Street Corporation") from terminating certain contracts and leases. Now before us are cross motions for summary judgment and defendant's motion to dismiss the complaint. For reasons which follow, we grant plaintiff's motion for summary judgment.[1]

The Parties

Defendant 14th Street Corporation is the cooperative owner of a 429 unit apartment house situated on the corner of Fifth Avenue and 14th Street in Manhattan. Its stockholders include persons owning about 85 percent of the building's units who purchased shares of capital stock and received proprietary leases when the building was converted to cooperative status on September 6, 1984. The occupants of the remaining units, having declined to purchase cooperative shares, remain as tenants under statutory leases protected by New York City's rent stabilization laws.

Each of the three plaintiff corporations is party to a lease or contract with defendant dated September 6, 1984. West 14th Street Commercial Corporation has a contract which, for a specified annual payment, authorizes it to lease to the public at any price it can obtain space for four stores on the building's ground floor. This lease is for a term of 20 years with an option to renew for another 20 years. West 14th Street Garage Corporation has a similar 20 year renewable lease authorizing it to operate a parking garage in the building. West 14th Street Laundry Corporation has a 15 year concession to provide and

1. Although the respective affidavits before us contain much colorful and conclusory language impugning the integrity and veracity of the respective parties, no one has pointed to a specific material fact actually in dispute.

service washing machines and dryers for the use of building residents.

The defendant and each of the plaintiff corporations were created by Parker 14th Associates ("Parker" or "sponsor"), the original owner and builder of the apartment house, for the purpose of effectuating its conversion from rental to cooperative status.[2]

The Conversion

The entire process of converting the building from rental to cooperative status lasted from the spring of 1982, when the four mentioned corporations were created, to September 6, 1984, when defendant 14th Street Corporation received title to the building and issued shares of its capital stock and proprietary leases to purchasing tenants. Conversion was effected pursuant to applicable provisions of the Martin Act, New York General Business Law §§ 352-e *et seq.* (McKinney 1984), which governs all cooperative conversions in New York City.

A brief description of the Martin Act's comprehensive regulation of the conversion process will aid understanding of the facts in this case. The statute was enacted for the protection of "tenants in possession who do not desire or who are unable to purchase the units in which they reside from being coerced into vacating such units by reason of deterioration of services or otherwise into purchasing such units under the threat of immediate eviction." Legislative Findings, 1982 N.Y. Laws § 1, ch. 555. Particular protection is granted to persons sixty-two years of age and older. Thus, the legislature found (*Ibid.*):

> that in the City of New York the position of non-purchasing tenants who are sixty two years of age or older is particularly precarious by reason of the limited financial resources of many such persons and the physical limitations

2. Parker also created a corporation known as Parman Company to act as sponsor for the conversion. For all purposes here relevant, Parker and Parman may be considered a single entity and will consequently be referred to interchangeably as "Parker" or "Sponsor".

> of many such persons; that preventive action by the legislature in restricting rents and evictions during the process of conversion from rental to cooperative or condominium status is imperative to assure that such conversions will not result in unjust, unreasonable and oppressive rents and rental agreements affecting non-purchasing tenants especially those who are sixty-two years of age or older, and other disruptive practices affecting all tenants during the conversion process which threaten the public health, safety and general welfare. . . .

To address these issues, the statute provides two avenues by which an owner (such as Parker) can convert a building. The first, known as an "eviction plan", authorizes the conversion sponsor to convert the building and then cancel the leases of and force out non-purchasing tenants. At the time Parker was first contemplating conversion, that avenue required that the sponsor, as a condition precedent to declaring the plan effective, obtain from tenants written commitments for the purchase of 35 percent of the units in the building.[3] The second method, called a "non-eviction plan", reduces the required number of purchase commitments to 15 percent but imposes on the sponsor the obligation to honor the lease of any tenant who does not wish to purchase but elects to continue renting.[4]

The statute extends particular protection to senior citizens and disabled persons. Senior citizens are all persons over the age of 62 and their spouses. N.Y. Gen. Bus. Law § 352-eeee(1)(f). Disabled persons are those with a physical or psychological condition which prevents them from working and their spouses. § 352-eeee(1)(g). The statute mandates that any such person who elects within a given time not to purchase may not be

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3. The statute was amended in 1982 to raise the required number of purchase commitments to 51 percent. 1982 N.Y. Laws § 1, ch. 555.

4. This 15 percent purchase commitment can be made by tenants or bona fide purchasers who represent that they will await vacancy of the unit purchased (i.e., await expiration of the lease of the tenant then in possession) and that they will use the unit as their personal or family residence. N.Y. Gen. Bus Law § 352-eeee(1)(b) (McKinney 1984).

evicted (even pursuant to an eviction plan). § 352-eeee(d)(iii). In addition, the statute continues the applicability of any governmental regulation such as rent control or rent stabilization laws in effect at the time of conversion, § 352-eeee(d)(iv), and directs that tenants whose leases are not so protected may not be charged rent increases above those charged for apartments in buildings with comparable services. § 352-eeee(d)(iii).[5]

Parker's original intention was to avail itself of the provisions for an "eviction plan". It thus would have been required to obtain commitments for the purchase of 35 percent of the units in the building and would have been entitled to evict those who did not buy (except, of course, nonpurchasing elderly or disabled tenants).

Upon learning of Parker's intention, the tenants immediately organized an association called the Tenants Unity Group ("Unity Group") to present Parker with a united front in the contemplated negotiations. Unity Group's purposes, set forth in its Articles of Association, were to disseminate to tenants information about the conversion, to hire lawyers and expert consultants, and "to secure unified action in advancing the common interests of its members."

Unity Group's first significant action was to persuade 65 percent of the tenants to enter into a "no-buy pledge" contract committing them to refrain from purchasing any apartment under an eviction plan.[6] Upon learning of this action, Parker abandoned all efforts to employ that form of conversion.

Parker's first formal offer — made under the noneviction provisions of the Martin Act — was presented in July, 1982. This offer ("offering plan") was a comprehensive document setting forth all elements of the proposed conversion. Two of its provisions were of particular significance for present purposes. First,

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5. These provisions were contained as well in the version of the act which existed when Parker began considering conversion. Section 352-eeee(2)(a), 1979 N.Y. Laws Ch. 432, as amended 1981 N.Y. Laws Ch. 384.

6. Such a contract is enforceable in a court of law. *See , e.g., 227 East 12th St. Assn. v. 227 East 12th St. Tenants' Assn.* (S.Ct. N.Y. Co.) N.Y.L.J. Sept. 7, 1982, p.7, col. 3; McKinney's Practice Commentary to Article 23-A of N.Y. Gen. Bus. Law, "Real Estate Financing," § IV(c)(2) (1984).

it provided that the proposed cooperative corporation's stock be issued to tenants at a price of $80.00 per share. At this price, a typical two-bedroom apartment would cost $85,920.00. Second, it proposed that the corporation enter into contracts with the three present plaintiffs for the above-described purposes. Under this proposal, the building would receive: (a) from West 14th Garage Corporation, a rent of $25,000 per year for the first five years, increments every five years thereafter, and an annual rent in the twentieth year of $31,000; and (b) from the West 14th Street Commercial Corporation, $50,000 per year for the first five years, increments every five years thereafter, and a final annual rent of $65,000. Had the plan been accepted, the building would have received from the two corporations a total of $75,000 in the first year and $96,000 in the twentieth.[7]

The first section of the offering plan was titled "Special Risks." It explained that these contracts might not be "arms-length" arrangements, that the cooperative corporation would likely receive from them less than the full market value of the permitted operations, and that Parker would correspondingly profit therefrom. Thus, it stated:

> 2. The Plan provides for leases of the garage-space and commercial space by the Apartment Corporation [defendant] to the Owner or a related entity [plaintiffs]. These leases may not be "arms-length" transactions and may result in the Apartment Corporation's realizing *less* than the full economic value of the garage-space and commercial space. The difference realized over the terms of such leases may be deemed additional profit to the Owner [Parker]. Furthermore, over the years the rent payable under these leases may become increasingly less than the said portion of the Apartment Corporation's aggregate costs in maintaining these spaces. (emphasis in original).

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7. Although defendant when terminating these two contracts cancelled the laundry concession as well, it appears that that concession was never mentioned in the parties' negotiations. It will not, therefore be again mentioned in this opinion.

Appendix B

Only a handful of tenants elected to purchase under this offer, but it immediately sparked formal negotiations between Parker and Unity Group. Foremost among the issues upon which these negotiations centered was the price at which the tenants could purchase their apartments (i.e., the price per share of cooperative stock). Not surprisingly, the tenants wished to obtain the most favorable possible below-market "insider's price".

With respect to the challenged contracts, Unity Group expressed its outright opposition to their inclusion in any conversion plan, and otherwise sought, should their inclusion be unavoidable, to increase the revenues the cooperative corporation would receive under them. Prospective tenant purchasers obviously had a vital interest in this issue. If they succeeded in eliminating the contracts, the cooperative corporation would — as Parker had explained in its offering plan — increase revenues from the operations pre-empted by them and could apply that income to maintenance and other charges otherwise payable by tenants. By the same token, if the existence of the contracts were accepted, the loss of revenues to the cooperative corporation could nonetheless be minimized by increasing the payments required of plaintiffs. Parker, on the other hand, had a vital interest in that to the extent it could assure itself of future revenue from plaintiff corporations, it would be more willing to yield to the tenants' demand for lower prices for their apartments.

Aside from negotiations concerning these matters, there were discussions as to the size of the reserve fund that Parker would contribute to the cooperative, terms of downpayment, sponsor financing, covenants restricting the types of stores to be chosen under the commercial lease, and the terms of the sponsor's management agreement.

Without attempting a detailed account of the various negotiations which occurred, it is fair to say that each of the above considerations was taken into account in arriving at the final offering plan.

There were three major amendments to the plan. To declare the plan effective, Parker needed purchase commitments for 15 percent, or 65, of the building's units. Until the first amendment was made, Parker was able to obtain purchase commitments for

only four units. After the first amendment commitments for 31 units were received. Parker was able to obtain the 15 percent commitment only after it had issued the third amendment.

The third and final amended plan reduced the original offering price per cooperative share by 40 percent to $49.90. At this price, the two bedroom apartment which would have cost $85,900 under Parker's original offer was to be sold for $53,600. We are informed that the current market value for such an apartment is about $160,000. With respect to plaintiffs' contracts, the tenants were wholly unsuccessful in their efforts to eliminate them, but did succeed in increasing the revenue that the defendant corporation would receive therefrom. Thus, the initial rent to be received under the garage lease was raised from $25,000 to $44,000, with a final annual rent of $50,000. The base rent under the commercial lease was raised from $50,000 in the first year to $80,000, with a final rent of $95,000 (up from $65,000). In all, the tenants managed to increase income from these leases from $75,000 to $124,000 in the first year and $96,000 to $145,000 in the last. Further, the building reserve fund was increased from $50,000 to $650,000, the downpayment required of purchasing tenants was reduced from 10 percent to $1,000, a covenant restricting the type of store that could share in the commercial lease was inserted, and Unity Group recovered from Parker $30,000 for counsel fees and engineering costs.

The manner in which the tenants viewed their bargaining position in these negotiations is revealed by various writings contemporaneously generated by Unity Group. One of the early — if not the first — general meetings of tenants conducted by Unity Group was called for the purpose of discussing the news that Parker might propose an eviction plan. The formal minutes of that meeting described how a "no-buy" pledge could thwart that purpose, and went on to say that the Unity Group's general purpose was "to determine whether the building goes co-op, and if so, on whose terms." The relevant portion of those minutes provided (Minutes of January 30, 1981 Unity Group meeting):

> A "NO-BUY" PLEDGE is an agreement signed by all tenants, stating that they will not buy their apartment

> unless certain specified conditions are met by the sponsor. The use of this "tool" shifts the balance of power back to the tenant because now a majority of them will be necessary—not a mere 35%—to determine whether the building goes co-op, and, if so, on whose terms. Accordingly to [Unity Group's counsel], anything and everything in the "red herring" [the offering plan] can be changed.

In furtherance of its stated objective to see that the conversion took place on the tenants' terms, Unity Group kept its membership advised of its objections to the various plans proposed as well as their best course of action. For example, with respect to the first amendment, Unity Group cautioned tenants not to be stampeded into signing subscription agreements because the price per share was still too high and the rents under the proposed contracts with plaintiffs still too low. Unity Group Letter dated May 22, 1983. Subsequently, Unity Group advised tenants that "[i]f we stick together and do not buy, the negotiating committee will have additional negotiating sessions. However, if a substantial number of tenants decide to buy, there will be no reason for Parker to improve the deal." Unity Group Letter dated June 14, 1983.

The third (or final) amended plan seemed to meet with Unity Group's approval. On September 16, 1983 it called a meeting of the tenants for the purpose of reviewing a proposal which Parker was preparing pursuant to a tentative agreement between it and Unity Group, and which seemed "very likely" to be "acceptable to the tenants." In its circular of the above date, Unity Group cautioned tenants to ignore any approaches from Parker until its new plan had been duly considered at the proposed meeting. The prediction that the new plan would be "acceptable" turned out to be accurate. By January 6, 1984, the last date under the Martin Act on which Parker could declare the plan effective or have it deemed abandoned, Parker had received purchase commitments for 154, or 36 percent, of the building's units.

Parker hesitated, however, to declare the plan effective because it desired more sales. Counsel for Unity Group, as well as Unity Group's president (now president of defendant corporation) assured Parker that close to 80 percent of the building's apartments would be purchased under the final amended plan. Upon that prediction, Parker on January 6, 1984 declared the plan effective. Within about three weeks, it received commitments for an additional 211 apartments, raising to 85 percent the number of apartments purchased under the final plan. In all, about 80 percent of the building's tenants chose to purchase their apartments.

Because of the provisions of the Martin Act, those tenants who did not elect to buy cooperative stock were nonetheless entitled to continue renting their apartments under their prior leases for as long as they wished. Such continued rental was governed, as it had been prior to conversion, by New York City's rent stabilization laws.

Because the mortgage on the building was federally insured, Parker could not effect the conversion without first obtaining the approval of the Department of Housing and Urban Development ("HUD"). HUD's review, so far as is here relevant, resulted in a requirement that its approval be sought before any leases were terminated or the garage rates raised. HUD also required Parker to substantiate that the proposed garage rates were not higher than those in the immediate area.

At the closing held on September 6, counsel for Unity Group, who had led the conversion negotiations from the beginning, examined the title, leases, and documents pertaining to conditions of conversion. Last minute changes and adjustments were made. According to the terms set forth in the offering plan as amended, Parker conveyed title of the building to defendant, whose Board of Directors had been designated by Parker upon its creation back in 1982, and defendant simultaneously issued to purchasing tenants shares and proprietary leases at agreed-upon prices and signed the contracts with plaintiffs provided for by the amended offering plan.

About one month after the closing, the defendant corporation held its first general shareholders meeting.[8] The existing Board of Directors requested ratification of all actions taken to date. This request was denied by shareholder vote. A new slate of directors was elected.[9] These included many of the leaders of Unity Group, including the head of that association who was elected president of defendant corporation.

On June 12, 1985, these directors, with the support of over two thirds of the defendant's shareholders, purported to cancel the contracts here at issue. This lawsuit followed.

The Federal Statute

Defendant's purported cancellation of plaintiff's contracts was made in reliance upon Section 3607 of the Condominium and Cooperative Abuse Relief Act of 1980. 15 U.S.C. 3601 et seq. (1982). Section 3607, "Termination of Self-Dealing Contracts" provides — as its title indicates — for methods of relieving a newly created cooperative of self-dealing contracts into which it may have entered while the former owner was still in control. It provides in relevant part as follows (the most pertinent wording being emphasized):

> (a) Any contract or portion thereof which is entered into after October 8, 1980, and which —
>
> (1) provides for operation, maintenance, or management of a condominium or cooperative association in a conversion project, or of property serving the condominium or cooperative unit owners in such project;
>
> (2) is between such unit owners or such association and the developer or an affiliate of the developers;
>
> (3) was entered into while such association was controlled by the developer through [A] *special developer control or*

8. The date of this meeting had been fixed by the offering plan.

9. The offering plan had provided that such directors be elected at the first shareholders meeting.

> [B] *because the developer held a majority of the votes in such association*; and
>
> (4) is for a period of more than three years, including any automatic renewal provisions which are exercisable at the sole option of the developer or an affiliate of the developer, may be terminated without penalty by such unit owners or such association.[10]

Such termination must be approved by two-thirds of the units cooperative not owned by the developer or its affiliate, 15 U.S.C. 3607(c), and must occur within two years after "special developer control over the association is terminated." 15 U.S.C. 3607(b)(1). Such termination is effective 90 days after parties to the contract are given notice. 15 U.S.C. 3607(d).

The statute was enacted to remedy certain abuses in conversions of rental housing into condominiums and cooperatives. Specifically, Congress found that (15 U.S.C. 3601(a)):

> 1) there is a shortage of adequate and affordable housing throughout the Nation, especially for low- and moderate-income and elderly and handicapped persons;

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10. The "cooperative association" referred to is defined as (15 U.S.C. 3603(9)):

> [the] organization that owns the record interest in the residential cooperative property or a leasehold of the residential property of a cooperative project and that is responsible for the operation of the cooperative project.

A "cooperative unit owner" is (15 U.S.C. 3603(13)):

> the person having a membership or share interest in the cooperative association and holding a lease, or other muniment of title or possession, of a cooperative unit that is granted by the cooperative association as the owner of the cooperative property.

"Special developer control" is (15 U.S.C. 3603(22)):

> any right arising under State law, cooperative or condominium instruments, the association's bylaws, charter or articles of association or incorporation, or power of attorney or similar agreement, through which the developer may control or direct the unit owners' association or its executive board. . . . .

> 2) the number of conversions of rental housing to condominiums and cooperatives is accelerating, which in some communities may restrict the shelter options for low- and moderate-income and elderly and handicapped persons; . . .

Congress accordingly sought through the statute (15 U.S.C. 3601(b))

> . . .to seek to minimize the adverse impacts of condominium and cooperative conversions particularly on the housing opportunities of low- and moderate-income and elderly and handicapped persons, [and] to assure fair and equitable principles are followed in the establishment of condominium and cooperative opportunities

* * * * *

The legislative history illustrates the sort of evil the statute, of which section 3607 is a part, was meant to cure. Senator Williams, in the context of discussing the Congressional conference committee's action on the proposed statute, stated that the section was prompted by the humanitarian consideration of relieving tenants, particularly the elderly, from being forced to relocate because of a conversion, which relocation sometimes took several months. 126 Cong. Rec. § 13948 (daily ed. Sept. 30, 1980). This concern with the displacement of tenants was echoed by Representative Reuss, who noted that there was nothing wrong with a conversion which did not so displace tenants but which allowed them to remain until they relocated for other reasons. 126 Cong. Rec. H 10095 (daily ed. Sept. 30, 1985).

DISCUSSION

The basic question presented by this lawsuit can be simply stated. Should the occupants of 5-19 West 14th Street, having spent over a year reaching an agreement with their landlord on the price at which and the terms under which they were willing to give up the protection of New York City's rent laws and

become the building's owners, be allowed to repudiate such agreement as soon as they had acquired title pursuant to its terms? Plaintiffs advance two reasons for answering that question in the negative. First, they contend that the thrust of the Condominium and Cooperative Abuse Relief Act of 1980 (the "Act") , 15 U.S.C. 3601 et seq., is to prevent tenants — especially the elderly and disabled — from being deprived of shelter, and that it is therefore inapplicable to the instant non-eviction conversion where no tenant could have been so deprived. Second, they assert that section 3607 is by its terms inapplicable to the contracts here involved. For reasons which follow, we reject the first contention but accept the second.

Plaintiffs' first argument is indeed an attractive one. There can be no doubt that the main purpose behind the Act was to protect tenants — especially the aged and disabled — from being deprived of shelter by cooperative or condominium conversions. It is also clear that no tenant — whether elderly and disabled or youthful and robust — was or could have been so deprived in the conversion before us. However, in section 3607 Congress departed from its declared principal purpose, and focused on protecting newly formed cooperative corporations rather than their individual tenants. That section seeks to protect such entities from self-dealing contracts entered into when the landlord (or "sponsor") is still in control of their destinies. Attractive though it may be, we must therefore reject plaintiffs' first argument.

Turning to the applicability of the section invoked, its title indicates that it was intended to apply only to "self-dealing" contracts. The definitions set forth in subdivision (a)(2) make clear that its substantive provisions deal only with contracts "between" the sponsor or its affiliates and unit owners (defined in section 3603(13) as owners of cooperative association stock and holders of proprietary leases granted by it) or the cooperative association (defined in section 3603(9) as the organization owning the record interest in the cooperative property and responsible for its operation), while subdivision (a)(3) specifies that the contracts must have been "entered into" while the developer (Parker) controlled the cooperative association.

The instant contracts meet none of these criteria.[11] They were in no sense "self-dealing" but, as above indicated, were the result of arms-length bargaining conducted over the period of more than a year.[12]

Nor were they in any realistic sense between Parker and the defendant corporation as such or its unit owners. As to the latter, there were no unit owners at the time the contracts were executed because shares of the corporation did not exist until the moment the contracts came into being. Similarly, the defendant corporation as such played no part in negotiating or executing the contracts. The contracts came into being as a result of the pre-existing negotiations between Parker on the one hand and Unity Group representing the tenants on the other. These negotiations were ratified at the closing when Parker conveyed title to the defendant corporation and 80 percent of the tenants purchased shares in that corporation pursuant to the previously negotiated arrangements.[13] Neither defendant corporation nor

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11. Because of this ruling, we do not consider plaintiffs' argument that the requirements of subdivision (a)(1) have also not been met.

12. The parties devote a great deal of argument to the wholly irrelevant question of whether the sponsor or the tenants had the better bargaining position. Their respective bargaining positions were reflected in the bargain ultimately struck. As a practical matter, such positions were a function of the respective parties' desire to be rid of or to retain the restrictions of New York City's rent regulations. Furthermore, although not here applicable, the statutory provisions for termination of unconscionable leases in the companion section to the one here relied upon, 15 U.S.C. 3608, offer guidance into the factors we should consider in determining whether the contracts were self-dealing. Among them are the commercial setting of the negotiations, 15 U.S.C. 3608(c)(1), and whether any person has knowingly taken advantage of another. 15 U.S.C. 3608(c)(2). Relevant evidence would include that as to the "adequacy of disclosure of the [contract's] terms", Comments of Senator Williams, 126 Cong. Rec. S. 13949 (daily ed. Sept. 30, 1980). The contracts here were fully and forthrightly disclosed on page one of the offering plan, and were the subject of extensive and serious negotiations between Parker and the legal representative of an organized tenants association for over a year. They could hardly under such criteria be deemed self-dealing.

13. Although purchasing tenants and Parker behaved as though they had a binding contract as soon as subscription agreements were signed, and the plan declared effective, it cannot be said that the contracts had been made at that

plaintiff corporations, as such, participated in the closing which gave birth to contracts here in issue. We consequently conclude that the statute does not apply to this particular transaction.

Assuming *arguendo* that the contracts were — despite the nature of their origin — deemed to be "between" Parker and the defendant corporation, we would have to consider whether the provisions of section 3607(a)(3) had been met. Since no one has ever contended that Parker ever held a "majority of the votes" in the defendant corporation, the question narrows down to whether Parker exercised "special developer control" as defined in subdivision 22 of section 3603. That section specifies that such control must arise under state law, under the corporation's charter or by-laws, under a power of attorney or similar instrument, or under "cooperative or condominium instruments." It is apparent that with the possible exception of "cooperative or condominium instruments", none of the foregoing criteria are met. The term "cooperative or condominium instrument" being nowhere defined, it could be argued that because the offering plan specified that the pro forma directors originally designated by Parker at the corporation's birth should continue in office until the first meeting of shareholders, the criteria of section 3603(22) had been met.

Such an interpretation would exalt form over substance to an absurd degree. There was no causal relationship between the identity of defendant's directors and the existence of these contracts. Had Unity Group insisted upon amending the offering plan to provide that its own executive committee should become the defendant's directors at the moment of closing, such directors could not have prevented the execution of the contracts. They would have been faced with the choice of accepting from Parker title to the building on terms which had been agreed upon or presiding over a shell corporation with no assets. We decline to assume that Congress contemplated the absurd result

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time. Under the offering plan, Parker reserved the right to amend its terms any time before or after it was declared effective (and prior to the closing) so long as purchasing tenants were given the option of reaffirming or cancelling their agreements. Offering Plan at section BB(5)(a)(b). The subscription agreements thus were not binding contracts for want of mutuality.

of having substantive rights turn upon such a fortuitous and wholly meaningless circumstance. *See Commissioner of Internal Revenue v. Brown* (1965) 380 U.S. 563, 571 (courts should avoid construing statutes to produce absurd results); *Guiseppi v. Walling* (2d Cir. 1944) 144 F.2d 608, 624 (L. Hand, J.) (court's task is to predict what legislature would have done had it been presented with situation under review).

We accordingly deny defendant's motions and grant summary judgment for plaintiffs. Plaintiff shall submit a judgment on ten days notice.

SO ORDERED.

DATED: New York, New York
January 13, 1986

WHITMAN KNAPP, U.S.D.J.

APPENDIX C

Cases Pending Under Condominium and Cooperative Abuse Relief Act of 1980, 15 U.S.C. § 3601, *et seq.*

Federal Cases:

A. William King v. 415 Owners Corp., et al., No. 86-4800 (S.D.N.Y. filed June 18, 1986)

Brabert Realty Corp. v. 20125 Owners Corp., No. 86-5977 (S.D.N.Y. filed Aug. 1, 1986)

Cromwell Associates v. Oliver Cromwell Owners, Inc., No. 87-0784 (S.D.N.Y. filed Feb. 5, 1987)

Denton Garage Associates v. 11 Riverside Drive Corp., No. 86-4467 (S.D.N.Y. filed June 6, 1986)

Elan Corp. v. Reade Street Tenants Corp., No. 86-3131 (S.D.N.Y. filed Apr. 18, 1986)

520 East 72nd Commercial Corp., et al. v. 520 East 72nd Owners Corp., No. 86-7581 (S.D.N.Y. filed Oct. 3, 1986)

181 East 73rd Street Co. v. 181 East 73rd Tenants Corp., No. 87-3362 (S.D.N.Y. filed May 15, 1987)

305 East 24th Owners Corp., et al. v. Parman Co., et al., No. 85 Civ. 3788 (S.D.N.Y. filed May 20, 1985)

245 Central Park Associates v. Alden Owners Inc., No. 87-3522 (S.D.N.Y. filed May 21, 1987)

210 Associates v. 210 Central Park South Inc., No. 86-7018 (S.D.N.Y. filed Sept. 11, 1986)

West 14th Street Commercial Corp., et al. v. 5 West 14th Owners Corp., No. 85-5138 (S.D.N.Y. filed July 3, 1985)

State Cases:

Park East Apartments Inc. v. 233 East 86th Street Corp., et al., No. 87-50296 (Civ. Ct. N.Y. Co. filed Jan. 6, 1987)